



STEVE WESTLY
California State Controller

October 31, 2006

K-12 Local Education Agencies, Joint Power Entities,
Charter Schools, Sponsoring Charter Entities, and
Certified Public Accountants Performing Audits of K-12 Local
Education Agencies, Joint Power Entities, and Charter Schools

Subject: Annual Audits for fiscal year (FY) 2005-06

This advisory provides information to assist independent auditors in performing the FY 2005-06 audits of Local Education Agencies (LEAs), which include Joint Power Entities and charter schools.

Procedural

1. The requirements specified in *Education Code* 41020 are applicable to all LEAs, including Joint Power Entities and charter schools. As a result, audits shall be conducted in accordance with auditing standards generally accepted in the United States of America; the standards set forth in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the provisions of *California Code of Regulations* Title 5 Education, Section 19810, and following.
2. The report shall be presented as prescribed in the *Standards and Procedures for Audits of California K-12 Local Educational Agencies 2005-06*. For additional guidance, refer to the American Institute of Certified Public Accountants (AICPA) *Audit and Accounting Guide for State and Local Governments* and the AICPA *Government Auditing Standards and Circular A-133 Audits* with conforming changes as of May 1, 2006.
3. Charter schools that are included in the sponsoring entity's financial statement audit are not required to submit a separate report to the State Controller's Office (SCO), the California Department of Education (CDE), or the County Office of Education (COE).

4. For audits where charter schools are included in the district's financial statement audit, the auditor is expected to stratify the sample so that a representative number of charter schools (classroom and non-classroom based) are tested annually for state compliance and federal compliance, if applicable. In cases where a district has only one charter school, the auditor must apply state compliance audit procedures annually.
5. The State's report certification process requires that the SCO perform a desk review of the LEA's annual audit report. The review will ensure that the audit report meets the minimum reporting standards contained in the audit guide. The SCO will then reject or certify the report.

If the SCO rejects the report, a letter is sent to the independent auditor and LEA describing the exception noted during the SCO's review. The auditor has 30 days from receipt of the letter to make the correction. Upon receipt, the SCO will review the revised audit report and notify the auditor and LEA of the review results. The audit fee percentage stipulated in the audit contract must be withheld until the audit report is certified.

If the SCO certifies the report, the LEA and auditor will receive a letter stating that the audit report conforms to the reporting standards contained in the audit guide. The letter also specifies that the LEA may release the portion of the audit fee withheld under the provisions of *Education Code* Section 14505.

In those cases where the audit report contains a finding or findings that may be considered apportionment significant, the LEA receives a certification letter as described above, along with information on its appeal rights. The appeal rights allow the LEA 60 days from receipt of the SCO's certification letter to formally appeal any apportionment-significant audit findings to the Education Audit Appeals Panel (EAAP). The LEA may also request a summary review by the EAAP. The summary review request must be made within 30 days from the date of receipt of the SCO's certification letter. For more information on audit finding appeals, visit EAAP's Web site at <http://eaap.ca.gov/NewWebSite0804/EAAPAppeals.htm>

6. FY 2005-06 audit reports must be filed with the SCO, the CDE, the COE, and if applicable, the chartering entity by December 15, 2006. Independent auditors may submit the SCO's copy of the report electronically at leaaudits@sco.ca.gov or on a CD, providing the report is in a PDF file format and includes the independent auditor's electronic signature. All other entities require a hard copy of the report. The file size for electronic submission to the above e-mail address cannot exceed 7MB.

Mailing Address

State Controller's Office
Division of Audits
School District Audits
Post Office Box 942850
Sacramento, CA 94250-5874

Private Carrier Delivery

State Controller's Office
Division of Audits
School District Audits
300 Capitol Mall, Fourth Floor
Sacramento, CA 95814

7. The COE must submit a report extension request to the SCO and the CDE by December 1, 2006. The extension request must come from the COE and not the LEA. The SCO will not consent to the extension request unless the circumstance leading to the extension is extraordinary.

The SCO does not grant extensions for charter school audits. The extension must be obtained through the chartering entity and the chartering entity must notify the SCO and the CDE of the extension.

8. Certified public accountants or public accountants wanting to conduct LEA audits must be added to the Certified Public Accountants Directory published by the SCO. To be included in the directory, the CPA or public accountant must submit a written request to the SCO prior to conducting the audits. Instructions for submitting the request can be found at the SCO's Web site <http://www.sco.ca.gov/cpads/main/default.aspx>.
9. The auditor-rotation requirements specified in *Education Code* Section 41020 (f)(2) apply to auditors who conduct LEA audits. This section of the *Education Code* makes it unlawful for a public accounting firm to provide audit services to the LEA if the lead audit partner, or coordinating audit partner responsible for the audit or for reviewing the audit, has performed audit services for the LEA in each of the six previous fiscal years. Consequently, a different audit firm and/or audit partners must be used in the seventh year, unless a waiver is obtained from the Education Audit Appeals Panel.

Audit Guide

The audit guide is published by the Education Audit Appeals Panel (EAAP) pursuant to rulemaking procedures. The title of the audit guide for FY 2005-06 is *Standards and Procedures for Audits of California K-12 Local Educational Agencies 2005-06*. The audit guide is prescribed in *California Code of Regulations* Title 5 Education, Section 19810, and following. It is available through the EAAP's Web site at www.eaap.ca.gov.

Compliance

During the SCO's annual audit report certification process, a significant amount of time is spent corresponding with independent auditors regarding audit report deficiencies. To expedite certification of audit reports for the FY 2005-06, the SCO requests that auditors attend to the following when completing their audit reports.

1. The Auditor's Report on State Compliance must refer to *Standards and Procedures for Audits of California K-12 Local Educational Agencies 2005-06*, published by the Education Audit Appeals Panel.
2. The Auditor's Report on State Compliance must identify the state compliance requirements specified in Section 19816 (e)(3) of the *Standards and Procedures for Audits of California K-12 Local Educational Agencies 2005-06*. The report must include the number of procedures required by the audit guide and state whether or not the procedures were performed. An explanation must be included if certain procedures were not performed or if alternate procedures were performed.

3. The following compliance requirements were added to the audit guide in FY 2005-06.

K-12:

- Morgan-Hart Class Size Reduction Program, 7 procedures

Charter Schools:

- Contemporaneous Records of Attendance for charter schools, 1 procedure
- Nonclassroom-Based Instruction/Independent Study for charter schools, 15 procedures
- Additional Nonclassroom-Based Instruction for charter schools, 1 procedure
- Determination of Funding for Nonclassroom-Based Instruction for charter schools, 3 procedures
- Annual Instructional Minutes-Classroom Based for charter schools, 3 procedures

In addition, Class Size Reduction audit procedures apply to charter schools that received Class Size Reduction funding.

4. Each audit finding should be presented in the following level of detail:
 - State or Federal Program Information
 - Finding Code (e.g., 10000 Attendance, 20000 Inventory of Equipment)
 - Criteria or specific requirement
 - Condition
 - Effect
 - Cause
 - Questioned costs
 - Recommendation
 - LEA's corrective action plan
5. For state compliance findings, the financial impact must be quantified. The audit guide includes specific information that must be included in each finding. This information must be presented in order for the SCO to accept the finding. For example, for attendance findings, the audit guide requires that the audit report include a statement of the number of units of average daily attendance (ADA) that were inappropriately reported for apportionment and an estimate of their dollar value per ADA. If there is no financial impact, the finding must describe the reasons for the auditor's conclusion.
6. For single audits with federal compliance findings, the SCO will not accept reports in which federal findings are not presented in accordance with the Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, Subpart E–Auditors, Section .510.

Management Letter

Reportable conditions, such as any state compliance findings, should not be reported in the management letter. Generally Accepted Government Auditing Standards paragraphs 5.12 through 5.20, provide guidance showing when deficiencies in internal control and violations of contracts or grant agreements should be included in the auditor's report and when they should be included in the management letter. If issued, a copy of the management letter must be submitted along with the LEA's annual report.

This audit guide advisory is available on the Internet, at
<http://www.sco.ca.gov/pubs/index.shtml#guides>.

Should you have any questions or need additional information, please contact Casandra Moore-Hudnall, Chief, Financial Audits Bureau, Division of Audits, at (916) 322-4846.

Sincerely,

Original signed by

MICHAEL CARTER
Chief Operating Officer

MC/vb

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cc: Jack O'Connell
Superintendent
California Department of Education